

17 OCT 1973

MEMORANDUM FOR: CRS/ADD Release

SUBJECT:

Release of LDC Debt Service Burden: A
Comparison of Western and Communist
Programs, September 1973, Unclassified,
to Foreign Governments

1. It is requested that the attached copy of subject report be
forwarded as follows:

STATINTL

1 copy

2. All OER responsibilities as defined in the DDI memorandum
of 13 August 1952, "Procedures for Dissemination of Finished
Intelligence to Foreign Governments," as applicable to this report
have been fulfilled.

STATINTL

Chief, St/P/C/OER

1 Attachment

WORK COMPLETED

Dissemination requested by
this memorandum has been completed.

By: *mk*

Date: *10/18/73*

7 September 1973

STATINTL

MEMORANDUM FOR: [REDACTED] Chief
Africa Division, [REDACTED] JDO
SUBJECT : LDC Debt Service Burden:
A Comparison of Western and
Communist Programs

STATINTL

Attached is the unclassified paper which compares the burden on LDCs of repayments of Western and Communist aid. We apologize for the delay in getting it to you. It was held up in publication.

STATINTL

[REDACTED]
Chief
Developing Nations Division
Office of Economic Research

Attachment:
As stated

Distribution: (S-5407)

Orig & 1 - Addressee

1 - D/OER

1 - SA/ER

1 - St/P/C

1 - D/D

1 - D/TA

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OER/D/TA: [REDACTED] dao/x6202 (7 Sep 73)

10 SEP 1973

September 1973

LDC DEBT SERVICE BURDEN:
A COMPARISON OF WESTERN AND COMMUNIST PROGRAMS

Summary

1. The dilemma of increasing amounts of development assistance to the less developed countries (LDCs) in the face of rapidly expanding debt service is forcing a re-examination of the financial criteria for aid giving. Western nations, responsible for almost 95% of the gross bilateral flow of official capital to LDCs during 1954-72, are responding to international pressures to obtain uniform aid procedures. Communist countries are not. This situation exists in spite of the less favorable terms for Communist aid:

Communist aid has a smaller grant element than Western aid; it is paid off faster and absorbs a larger share of the annual gross capital flow; the cost per dollar of Communist aid delivered is higher than for Western aid; and Communist deliveries, net of payments for principal and interest, are declining while net Western aid transfers still are rising. The significant financial advantage of Communist aid is that it can be repaid in commodities (often not salable elsewhere) instead of hard currency. For some LDCs, this may mean the disposal of surplus goods for capital that will enhance development and generate employment.

2. Creditor nations expect the LDCs to meet repayment obligations and have provided debt relief only as a last resort. At the end of 1972 the LDCs had made principal and interest payments totaling about US \$21 billion for the almost \$115 billion of official bilateral capital provided them since the beginning of 1954. Still outstanding was some \$50

billion in debts. If repayment of the LDC debt were to increase as rapidly over the next five years as during the past five, annual debt service would rise to about \$6 billion in 1977, or twice the 1972 level. To sustain current net aid transfers in 1977, official bilateral capital flows would have to increase by about 30% to more than \$13 billion.

Discussion

Introduction

3. The nations of the Third World are trying to acquire increasing external capital assistance at a time when their rising foreign debt service is burdensome. Both Western and Communist donors are pressed to expand their aid undertakings on more concessionary terms, sometimes to countries that are not able to discharge current obligations or whose debt service is absorbing an inordinate amount of the capital inflow. Anxious to strengthen their political and economic relationships with the LDCs, both are seeking solutions to the debt service problem that will allow debtors to sustain development efforts without severely impairing their import capability.

4. A continuing increase in the net capital flow to LDCs implies a major expansion of gross disbursements, additional softening of repayment terms, or relief from current debt obligations. Each expedient has been employed, often in combination, but consistent long-term approaches to the problem have only recently begun to emerge. In spite of these problems, both Eastern and Western creditors expect LDCs to pay for assistance provided under credits. Aid recipients, on the other hand, are eager to meet their obligations so as not to impair their credit-worthiness in international markets. This publication compares the debt management and financial benefits to the LDCs of the economic aid provided by Western and Communist nations. It also compares Western and Communist efforts to cope with a dwindling margin between new economic aid and debt service on old programs.

Gross Capital Flows to the LDCs

5. During 1954-72 the LDCs received about \$113 billion in economic assistance from bilateral official sources in the developed world.* An estimated \$107 billion came from the West** and only about \$6 billion from Communist nations. Aid disbursements rose rapidly in the early years, climbing from an annual average of less than \$3 billion during 1954-59 to almost \$6 billion during the next five years. During 1965-69, aid outlays rose less rapidly because of relatively stable US disbursements. But, in 1970-71, deliveries rose by about 25% and approached a record \$10 billion a year.*** Although complete data for Western expenditures are not yet available for 1972, it is certain that they surpassed 1971 levels.

6. The recently expanded flow of capital reflects the rapid growth of disbursements by Western Europe and Japan. Increases in US aid have been small. US participation in the global flow totaled \$4 billion in 1971, 40% of the total. This was a drop from an average annual contribution of about 55% prior to 1970. The Communist countries' annual contribution to the global flow has been relatively constant since 1965 -- ranging between 6% and 7%. Their \$6 billion in aid deliveries was only about 10% as large as US aid deliveries of over \$55 billion and 40% as large as the \$15 billion provided by France, the second largest Western donor. Combined disbursements of the eight Communist nations were less than those of either the United Kingdom, Japan, or West Germany.

* Excluding private flows and multilateral assistance, which have totaled about \$80 billion.

** Throughout this publication, the term *West* refers to members of the Development Assistance Committee (DAC) -- Australia, Austria, Belgium, Canada, Denmark, France, Italy, Japan, the Netherlands, Norway, Portugal, Sweden, Switzerland, the United Kingdom, the United States, and West Germany.

***In addition, private gross flows, which have accounted for the greater part of the capital expansion flowing to LDCs in recent years, increased to \$12 billion in 1971, up from \$5 billion in 1965.

The Cost of Capital

7. Payments of principal and interest on aid from all bilateral official sources have absorbed about 20% of the total assistance provided. By 1970-71 these payments were about 30% of the annual total. For some recipients, the ratio was even higher, and for a few a reverse flow of resources was being generated, sometimes on both Communist and Western aid accounts. In the aggregate, LDC debt service has consumed a larger share of Communist than of Western aid. Principal and interest payments for Communist aid were some 30% of the total value of Communist aid deliveries. The ratio for Western aid was less than 20%. By 1971 almost one-half of Communist aid deliveries went for debt service. In contrast, repayments of LDC principal debt and interest to Western nations was absorbing only about 25% of the aid flow in 1971.

8. At the end of 1972, Third World nations had paid an estimated \$21 billion (\$14 billion for principal and \$7 billion for interest) on their bilateral official debt. About \$19 billion of the total went to Western nations and the remainder to the Communist countries (see the table). While both principal and interest payments moved consistently upward, especially since the mid-1960s, principal payments had grown faster. These accounted for 70% of total debt service in 1971, compared with about 60% in 1965. Increases in recent years reflect the onset of payments following the expiration of grace periods and the somewhat shorter repayment periods allowed on many new undertakings.

9. Service of the LDC debt for official bilateral economic assistance more than doubled between 1965 and 1972. Repayments of principal and interest in 1972 approached \$3 billion,* compared with only slightly more than \$1 billion seven years earlier. This means that debt servicing has grown as fast as the debt itself but much faster than aid receipts, which rose less than 50% between 1965 and 1971.

* Additional estimated payments due for private capital debt and dividends payments were roughly \$3.5 billion in 1971.

Estimated LDC Debt Payments
for Official Bilateral Economic Aid, by Donor
1957-72 1/

	Million Current US \$		
	<u>Total</u>	<u>Principal</u>	<u>Interest</u>
<i>Total</i>	21,300	14,300	7,000
Western countries	19,300	12,800 <u>2/</u>	6,500 <u>3/</u>
United States	10,500	6,750	3,750
Other	8,800	6,050	2,750
Communist countries	2,000	1,500	500

1. Data for 1972 are preliminary.
2. Excluding possibly as much as \$1 billion of principal payments to governments that are not DAC members.
3. Including estimates of interest paid to DAC countries for 1957-67.

10. On the average, LDC repayments to Communist creditors have grown somewhat faster than to Western creditors, but the relative share of Communist creditors in the total repaid has not changed significantly over the past decade. Between 1965 and 1972, LDC debt service on Communist aid tripled; it more than doubled for Western aid. Nevertheless, at the end of 1972 the LDCs still owed Communist nations about \$4 billion, representing about two-thirds of total Communist aid delivered since the beginning of 1954. Their debt to the West was approximately \$46 billion, or less than 45% of total Western aid deliveries. Because of a much higher grant element in Western aid, the debt service per dollar of Communist aid delivered has been more than one and one-half times as high as for Western aid. The debt service/delivery ratio for Communist aid is about 30%, compared with about 20% for Western aid. Although Communist countries have provided only about 5% of the official bilateral capital that has flowed to LDCs, they have claimed almost twice that share of the total repaid on aid accounts.

11. Amortization of the LDC debt to Communist countries also has proceeded at a higher rate than on LDC debt to the West, while interest as a share of the total repaid dropped somewhat on both Eastern and Western accounts in recent years. Interest has constituted a larger share of LDC repayments for Western aid (about one-third) because of higher average charges and longer grace and amortization periods for Western official loan capital. Interest payments for Communist aid have accounted for about one-fourth of the total repaid. Nevertheless, the cost per dollar of aid provided was less for Western than for Communist aid. This was mostly because of the more favorable Western terms. More than one-half of aid committed by Western nations and 45% of their deliveries have been grant aid.* Communist nations provided less than 5% of their total aid as outright grants, although, as a share of deliveries, grant aid was about 10%. In 1971, Western aid commitments allowed amortization over an average of 28.7 years, after an average grace period of 6.5 years. Communist commitments carried an average of 11.5 years for amortization.** Average interest rates for Communist aid have been lower than for Western aid. Communist aid extended in 1971 carried interest charges averaging less than 2%, compared with 2.8% for Western commitments. Nevertheless, during 1965-72, interest payments to Western nations equaled 8% of the total value of their aid deliveries; it was 10% of Communist deliveries.

* The United States, France, and the United Kingdom together provided more than 80% of the total grants. All Australian aid is grant aid.

** Grace periods for Communist aid cannot be compared with those for Western assistance because of definitional problems, except for the PRC which usually allows a 5-20 year lag between commitments and the onset of payments. Moscow normally requires initial principal payments one year after project completion, which may mean a delay in principal payments by 2-15 or more years after actual commitments are made.

The Size of LDC Debt

12. At the end of 1972, the LDCs still owed an estimated \$50 billion to other governments for bilateral economic aid deliveries,* more than three times principal payments already made. LDC outstanding debt had reached more than \$20 billion at the end of 1964, and then during 1965-68 it nearly doubled. Debt rose somewhat more slowly over the next four years (1969-72), but at the end of 1972 it was two and one-half times the level at the end of 1964.

13. LDC debt to the West grew at a somewhat higher rate than debt to Communist nations, but the relationship between deliveries and outstanding debt has been more favorable for Western than Communist aid. Thus, in spite of the failure of Communist aid deliveries to grow as part of the total and in spite of the faster pay-off on LDC aid debt to Communist nations, the LDCs still owed Communist countries an estimated \$4 billion at the end of 1972.

Net Aid Transfer: The Critical Factor

14. The size of a nation's debt is not necessarily a measure of strains on its economy, nor is the size of its debt service ratio.** Problems usually occur when the debtor cannot settle trade and aid accounts because debt servicing is encroaching on its import capacity. Thus, because of variations in domestic economic conditions, LDCs have sought debt relief at very different stages of indebtedness and at different debt service ratios. Generally, their problems reflect a combination of external and domestic factors that surface when debtors' foreign exchange availabilities are not adequate to honor external obligations or if, by honoring them, domestic development objectives are jeopardized.

* Private and privately guaranteed debt would probably add as much as \$40 billion to \$50 billion to this total. An additional \$10 billion to \$15 billion also may be outstanding for military aid deliveries.

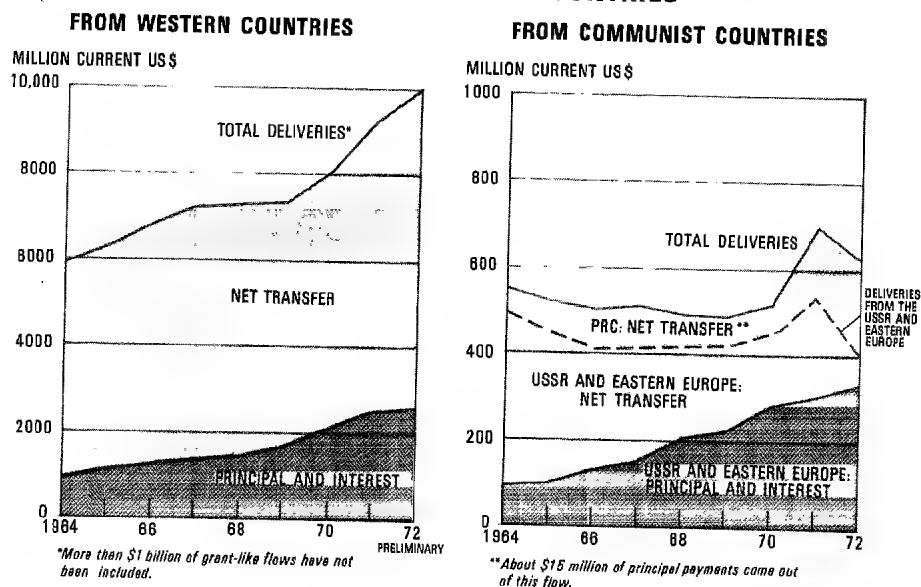
** The ratio between total debt service and total export earnings.

15. In accepting long-term repayment responsibilities, aid recipients weigh future liabilities against the contributions of additional foreign capital inputs to their domestic growth. Critical to the cost-benefit judgment, particularly as a short-run consideration, is net resource availability (i.e. gross aid deliveries, net of principal and interest). Because the actual net transfer of resources is a function of the size and terms of gross capital flows, it is an important criterion for judging relative benefits among aid programs.

16. The failure of capital flows to expand sufficiently to compensate for the more rapidly growing debt service has led to an overall deterioration in the expansion of net aid transferred over time. Even though gross capital flows to the Third World from official bilateral sources have been increasing in the past few years, the rate of increase, net of debt service, has decelerated, and net availabilities from some donors have dropped. Even the 15% increase in net official bilateral capital transfers during 1971 was considerably less than an effective addition to LDC capital availability because of inflation. Nevertheless, net aid transfers from the West have continued to grow. Since the beginning of 1965, those from Communist nations have fallen (see the chart). The divergence in the net transfer patterns between Communist and Western aid programs probably is the most important difference to have emerged between the two programs. It is the result of the much larger growth in gross flows from Western nations as well as qualitative differences in Western and Eastern programs. One of the most important factors responsible for the difference is the high grant element of Western aid (82% for commitments made in 1971).* Under the most liberal interpretation of current Communist aid terms, the grant element would be no more than 35%-40%.

* The grant element measures the concessionary element of aid terms. It is derived by relating the present value of interest, principal payments, and the length of the grace period.

NET TRANSFER OF OFFICIAL BILATERAL CAPITAL TO LESS DEVELOPED COUNTRIES



17. Net aid receipts from the West have grown in almost every year since 1954. They rose rapidly during the first decade of the aid program (1954-63) because of sharply expanding aid deliveries and large amounts of grant aid. Then, between 1964 and 1969 deliveries leveled off. More concessionary terms of aid and debt relief continued to provide some growth in receipts. Larger gross flows in 1970-72 again contributed to a continuing increase in Western net aid transfers. Meanwhile, the net flow of Communist aid had fallen in half between 1964 and 1972. The decline was noted in every year until 1971, when unusually large Chinese aid deliveries, made before large repayments on Chinese aid fell due, drove the net up somewhat. If Chinese aid deliveries are excluded from the Communist total, the narrowing gap between deliveries and repayments is even more pronounced. Unless there is a marked change in Communist aid policy, the net flow will fall to zero and then become negative in the next several years.

Impact of Debt Service on the LDCs

18. Debt service on all LDC accounts* was equivalent to about 15% of total merchandise exports from these nations in 1971, slightly higher than in 1966. The ratio is higher for some countries and groups of countries. For example, it was 25% for South Asia because debt payments more than doubled while merchandise exports increased by only 20% between 1965 and 1971. In the aggregate, the ratio of debt service to total merchandise exports** for Communist and Western official bilateral aid was roughly the same, but the ratio was far higher for the USSR than for the United States. Soviet debt service as a percent of LDC merchandise exports has run about twice as large as for the United States.*** During 1969-71, about 30% of total merchandise exports from Soviet aid clients was devoted to repayment of their aid debt to the USSR. During the same period, LDC repayments to the United States ranged between 10% and 15% of the total exports of LDCs that had received credits from the United States. In 1966 the ratio for the United States was 10%, compared with 25% for the USSR.

19. These ratios for Communist and Western countries may not be exactly comparable for measuring LDC ability to repay debts. Communist aid may be easier to repay than Western aid because of the "means of repayment." Most Western aid is tied to purchases in the donor country, but repayment of principal and interest is in free foreign exchange. Communist aid also is "tied," but repayment is in local goods. Commodities used as repayment for LDC debts to Communist creditors would be equivalent to hard currency payments if they could be sold for hard currency, but frequently these goods cannot be disposed of, because of their inferior quality, a lack of demand, or other barriers

* Based on data for 80 LDCs and including private and privately guaranteed debt servicing as well as multilateral global debt service.

** Merchandise exports are used for comparing Western and Communist ratios because export earnings data are not readily available for the latter nations.

***Includes only the LDCs that were in debt to the US and USSR in 1971.

in developed country markets. Communist willingness to accept cheap consumer goods from Egypt and India, foods from African nations, and crude products and raw materials not salable on world markets allows LDCs to pay their debt without creating pressures on limited foreign exchange reserves and hard currency earnings. It enables them to exchange otherwise surplus goods for development capital. Meanwhile, the demand for these goods generates domestic employment. Of particular advantage to the LDCs is the willingness of Communist nations to accept as repayment the output of plants built with Soviet aid, for which at least initially there may be no ready market. The weight of this repayment consideration differs among recipients, but it may be critical to the decision to accept Communist aid on what appears to be more burdensome terms than for Western aid: Iran's natural gas, previously flared as a waste product, is now paying for most of the annual flow of Soviet capital to Iran. Other Soviet-aided projects -- natural gas from Afghanistan, bauxite from Guinea, and alumina from Turkey -- will pay for Soviet aid. Steel rails from India and Soviet use of port facilities in Berbera, Somalia, also fall into this category.

Debt Relief

20. Debtor nations rarely have defaulted by outright refusal to honor their debts, and they have sought relief only as a last resort. Western and Communist creditors, although they both have been willing to renegotiate LDC repayment schedules where a real need has existed, have refused to provide automatic relief. In a *Pravda* article of 29 March 1973, Skachkov, Chairman of the State Committee of the USSR Council of Ministers for Foreign Economic Relations, stated: "Soviet economic assistance is not charity. It is given on a mutually advantageous basis and rests on the principles of equality and respect for mutual interest."

21. Both Western and Communist countries have given relief where there have been acute debt servicing problems.

22. Debt relief may take any of the following forms: (1) cancellation of the debt, (2) rescheduling of payments, or (3) refinancing the debt. Western nations are not known to have canceled principal payments although occasionally they have forgiven interest payments due. On a very few occasions, Communist countries have converted loans to grants.* Occasionally they have canceled interest payments. Debt rescheduling -- a rearrangement of maturities to eliminate a bulge in debt servicing -- is the most widely used form of relief provided by both Western and Communist creditors. The third form of relief -- refinancing (most commonly used by Western nations) -- implies a debt rollover in which new credits are extended to equal principal payments due on the outstanding debt. This relief implies that financed investments yield enough to pay the interest due. Sometimes debt rollover is combined with a rescheduling of maturities. Refinancing is not known to have been used directly as a relief device by Communist nations, although in some cases the resulting flow pattern after a rescheduling may effect a rollover.

23. Most major debt renegotiations with the West are conducted through multilateral channels, which create a procedural framework within which individual creditor nations effect bilateral settlements. These multilateral arrangements started in 1955 and 1956 to deal with large commercial arrearages accumulated by Brazil and Argentina with their West European trading partners. Broad rescheduling negotiations currently are under way among Western consortia with Chile, Ghana, India, and Pakistan. Communist countries usually have provided debt relief bilaterally, but often the East European nations follow Moscow's format. The renegotiation of Indonesia's debt to Communist nations was significant because most of the Communist creditors followed the Western accord.

* China's conversion to grants of \$100 million of credits extended in 1964 and 1968 to Pakistan-Bangladesh is the most recent example.

Outlook

24. The pressure of debt servicing on LDC resources will become more burdensome in the latter half of the 1970s. Long grace periods, which have begun to expire, on loans granted earlier; the decline in the amount of grant aid sometimes offset by a higher volume of lending; and less concessional terms by some major lenders all will contribute to a continuing rapid rise in debt service. Even if debt service were to grow only as fast in the next five years as it did in the last five, by 1977 LDCs would have to make approximately \$6 billion in interest and principal payments. To sustain the amount of net aid transferred in 1972, and assuming the same concessional terms, the gross capital flow would have to be increased by about 30%. Nevertheless, as LDC import requirements grow and debt service rises, more of the LDCs will be forced to seek relief, and further accommodation to their hard currency shortages may have to be made. Western nations have recognized the relationship between debt relief and the conditions of aid. Communist nations have not, although they are more circumspect in their aid undertakings than before. Communist nations will continue to stress the "mutuality of interest," and so long as local goods are in surplus but acceptable as repayment for Communist aid, the burden on LDCs of making these repayments will be less than for Western aid. Thus the "means of repayment" probably will continue to condition the acceptability of further Communist aid in spite of the heavier debt service responsibilities and a probable negative flow of aid. Western nations will have to continue to accommodate to the problems related to limited LDC foreign exchange availabilities and the erosion of aid availabilities for development. But if Communist nations are unable to absorb LDC export surpluses (or if LDC goods can be disposed of for hard currency), Moscow and Eastern Europe may be forced to conform more closely to optimum aid criteria being pressed on the developed nations in international councils.

September 1973

LDC DEBT SERVICE BURDEN:
A COMPARISON OF WESTERN AND COMMUNIST PROGRAMS

Summary

1. The dilemma of increasing amounts of development assistance to the less developed countries (LDCs) in the face of rapidly expanding debt service is forcing a re-examination of the financial criteria for aid giving. Western nations, responsible for almost 95% of the gross bilateral flow of official capital to LDCs during 1954-72, are responding to international pressures to obtain uniform aid procedures. Communist countries are not. This situation exists in spite of the less favorable terms for Communist aid:

Communist aid has a smaller grant element than Western aid; it is paid off faster and absorbs a larger share of the annual gross capital flow; the cost per dollar of Communist aid delivered is higher than for Western aid; and Communist deliveries, net of payments for principal and interest, are declining while net Western aid transfers still are rising. The significant financial advantage of Communist aid is that it can be repaid in commodities (often not salable elsewhere) instead of hard currency. For some LDCs, this may mean the disposal of surplus goods for capital that will enhance development and generate employment.

2. Creditor nations expect the LDCs to meet repayment obligations and have provided debt relief only as a last resort. At the end of 1972 the LDCs had made principal and interest payments totaling about US \$21 billion for the almost \$115 billion of official bilateral capital provided them since the beginning of 1954. Still outstanding was some \$50

billion in debts. If repayment of the LDC debt were to increase as rapidly over the next five years as during the past five, annual debt service would rise to about \$6 billion in 1977, or twice the 1972 level. To sustain current net aid transfers in 1977, official bilateral capital flows would have to increase by about 30% to more than \$13 billion.

Discussion

Introduction

3. The nations of the Third World are trying to acquire increasing external capital assistance at a time when their rising foreign debt service is burdensome. Both Western and Communist donors are pressed to expand their aid undertakings on more concessionary terms, sometimes to countries that are not able to discharge current obligations or whose debt service is absorbing an inordinate amount of the capital inflow. Anxious to strengthen their political and economic relationships with the LDCs, both are seeking solutions to the debt service problem that will allow debtors to sustain development efforts without severely impairing their import capability.

4. A continuing increase in the net capital flow to LDCs implies a major expansion of gross disbursements, additional softening of repayment terms, or relief from current debt obligations. Each expedient has been employed, often in combination, but consistent long-term approaches to the problem have only recently begun to emerge. In spite of these problems, both Eastern and Western creditors expect LDCs to pay for assistance provided under credits. Aid recipients, on the other hand, are eager to meet their obligations so as not to impair their credit-worthiness in international markets. This publication compares the debt management and financial benefits to the LDCs of the economic aid provided by Western and Communist nations. It also compares Western and Communist efforts to cope with a dwindling margin between new economic aid and debt service on old programs.

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Gross Capital Flows to the LDCs

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3. Including estimates of interest paid to DAC countries for 1957-67.

10. On the average, LDC repayments to Communist creditors have grown somewhat faster than to Western creditors, but the relative share of Communist creditors in the total repaid has not changed significantly over the past decade. Between 1965 and 1972, LDC debt service on Communist aid tripled; it more than doubled for Western aid. Nevertheless, at the end of 1972 the LDCs still owed Communist nations about \$4 billion, representing about two-thirds of total Communist aid delivered since the beginning of 1954. Their debt to the West was approximately \$46 billion, or less than 45% of total Western aid deliveries. Because of a much higher grant element in Western aid, the debt service per dollar of Communist aid delivered has been more than one and one-half times as high as for Western aid. The debt service/delivery ratio for Communist aid is about 30%, compared with about 20% for Western aid. Although Communist countries have provided only about 5% of the official bilateral capital that has flowed to LDCs, they have claimed almost twice that share of the total repaid on aid accounts.

11. Amortization of the LDC debt to Communist countries also has proceeded at a higher rate than on LDC debt to the West, while interest as a share of the total repaid dropped somewhat on both Eastern and Western accounts in recent years. Interest has constituted a larger share of LDC repayments for Western aid (about one-third) because of higher average charges and longer grace and amortization periods for Western official loan capital. Interest payments for Communist aid have accounted for about one-fourth of the total repaid. Nevertheless, the cost per dollar of aid provided was less for Western than for Communist aid. This was mostly because of the more favorable Western terms. More than one-half of aid committed by Western nations and 45% of their deliveries have been grant aid.* Communist nations provided less than 5% of their total aid as outright grants, although, as a share of deliveries, grant aid was about 10%. In 1971, Western aid commitments allowed amortization over an average of 28.7 years, after an average grace period of 6.5 years. Communist commitments carried an average of 11.5 years for amortization.** Average interest rates for Communist aid have been lower than for Western aid. Communist aid extended in 1971 carried interest charges averaging less than 2%, compared with 2.8% for Western commitments. Nevertheless, during 1965-72, interest payments to Western nations equaled 8% of the total value of their aid deliveries; it was 10% of Communist deliveries.

* The United States, France, and the United Kingdom together provided more than 80% of the total grants. All Australian aid is grant aid.

** Grace periods for Communist aid cannot be compared with those for Western assistance because of definitional problems, except for the PRC which usually allows a 5-20 year lag between commitments and the onset of payments. Moscow normally requires initial principal payments one year after project completion, which may mean a delay in principal payments by 2-15 or more years after actual commitments are made.

The Size of LDC Debt

12. At the end of 1972, the LDCs still owed an estimated \$50 billion to other governments for bilateral economic aid deliveries,* more than three times principal payments already made. LDC outstanding debt had reached more than \$20 billion at the end of 1964, and then during 1965-68 it nearly doubled. Debt rose somewhat more slowly over the next four years (1969-72), but at the end of 1972 it was two and one-half times the level at the end of 1964.

13. LDC debt to the West grew at a somewhat higher rate than debt to Communist nations, but the relationship between deliveries and outstanding debt has been more favorable for Western than Communist aid. Thus, in spite of the failure of Communist aid deliveries to grow as part of the total and in spite of the faster pay-off on LDC aid debt to Communist nations, the LDCs still owed Communist countries an estimated \$4 billion at the end of 1972.

Net Aid Transfer: The Critical Factor

14. The size of a nation's debt is not necessarily a measure of strains on its economy, nor is the size of its debt service ratio.** Problems usually occur when the debtor cannot settle trade and aid accounts because debt servicing is encroaching on its import capacity. Thus, because of variations in domestic economic conditions, LDCs have sought debt relief at very different stages of indebtedness and at different debt service ratios. Generally, their problems reflect a combination of external and domestic factors that surface when debtors' foreign exchange availabilities are not adequate to honor external obligations or if, by honoring them, domestic development objectives are jeopardized.

* Private and privately guaranteed debt would probably add as much as \$40 billion to \$50 billion to this total. An additional \$10 billion to \$15 billion also may be outstanding for military aid deliveries.

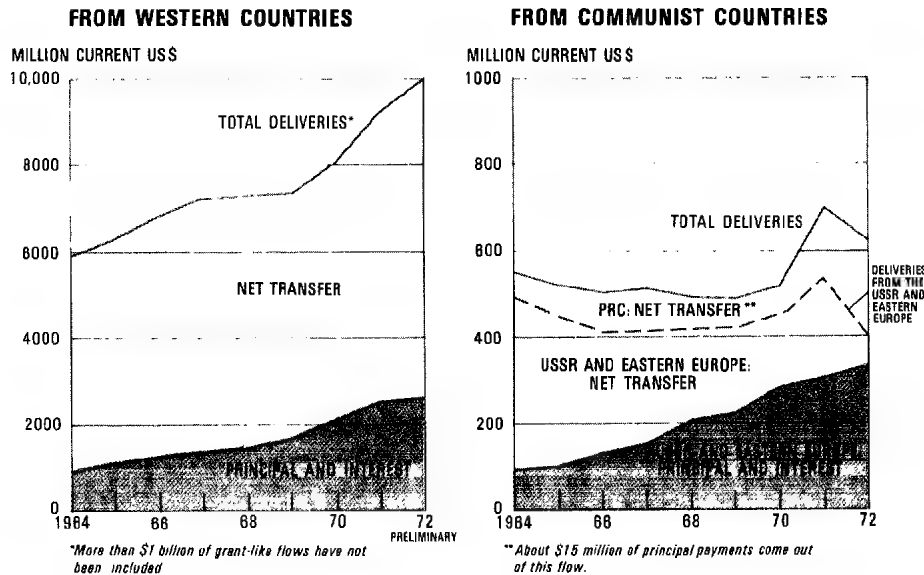
** The ratio between total debt service and total export earnings.

15. In accepting long-term repayment responsibilities, aid recipients weigh future liabilities against the contributions of additional foreign capital inputs to their domestic growth. Critical to the cost-benefit judgment, particularly as a short-run consideration, is net resource availability (i.e. gross aid deliveries, net of principal and interest). Because the actual net transfer of resources is a function of the size and terms of gross capital flows, it is an important criterion for judging relative benefits among aid programs.

16. The failure of capital flows to expand sufficiently to compensate for the more rapidly growing debt service has led to an overall deterioration in the expansion of net aid transferred over time. Even though gross capital flows to the Third World from official bilateral sources have been increasing in the past few years, the rate of increase, net of debt service, has decelerated, and net availabilities from some donors have dropped. Even the 15% increase in net official bilateral capital transfers during 1971 was considerably less than an effective addition to LDC capital availability because of inflation. Nevertheless, net aid transfers from the West have continued to grow. Since the beginning of 1965, those from Communist nations have fallen (see the chart). The divergence in the net transfer patterns between Communist and Western aid programs probably is the most important difference to have emerged between the two programs. It is the result of the much larger growth in gross flows from Western nations as well as qualitative differences in Western and Eastern programs. One of the most important factors responsible for the difference is the high grant element of Western aid (82% for commitments made in 1971).* Under the most liberal interpretation of current Communist aid terms, the grant element would be no more than 35%-40%.

* The grant element measures the concessionary element of aid terms. It is derived by relating the present value of interest, principal payments, and the length of the grace period.

NET TRANSFER OF OFFICIAL BILATERAL CAPITAL TO LESS DEVELOPED COUNTRIES



17. Net aid receipts from the West have grown in almost every year since 1954. They rose rapidly during the first decade of the aid program (1954-63) because of sharply expanding aid deliveries and large amounts of grant aid. Then, between 1964 and 1969 deliveries leveled off. More concessionary terms of aid and debt relief continued to provide some growth in receipts. Larger gross flows in 1970-72 again contributed to a continuing increase in Western net aid transfers. Meanwhile, the net flow of Communist aid had fallen in half between 1964 and 1972. The decline was noted in every year until 1971, when unusually large Chinese aid deliveries, made before large repayments on Chinese aid fell due, drove the net up somewhat. If Chinese aid deliveries are excluded from the Communist total, the narrowing gap between deliveries and repayments is even more pronounced. Unless there is a marked change in Communist aid policy, the net flow will fall to zero and then become negative in the next several years.

Impact of Debt Service on the LDCs

18. Debt service on all LDC accounts* was equivalent to about 15% of total merchandise exports from these nations in 1971, slightly higher than in 1966. The ratio is higher for some countries and groups of countries. For example, it was 25% for South Asia because debt payments more than doubled while merchandise exports increased by only 20% between 1965 and 1971. In the aggregate, the ratio of debt service to total merchandise exports** for Communist and Western official bilateral aid was roughly the same, but the ratio was far higher for the USSR than for the United States. Soviet debt service as a percent of LDC merchandise exports has run about twice as large as for the United States.*** During 1969-71, about 30% of total merchandise exports from Soviet aid clients was devoted to repayment of their aid debt to the USSR. During the same period, LDC repayments to the United States ranged between 10% and 15% of the total exports of LDCs that had received credits from the United States. In 1966 the ratio for the United States was 10%, compared with 25% for the USSR.

19. These ratios for Communist and Western countries may not be exactly comparable for measuring LDC ability to repay debts. Communist aid may be easier to repay than Western aid because of the "means of repayment." Most Western aid is tied to purchases in the donor country, but repayment of principal and interest is in free foreign exchange. Communist aid also is "tied," but repayment is in local goods. Commodities used as repayment for LDC debts to Communist creditors would be equivalent to hard currency payments if they could be sold for hard currency, but frequently these goods cannot be disposed of, because of their inferior quality, a lack of demand, or other barriers

* Based on data for 80 LDCs and including private and privately guaranteed debt servicing as well as multilateral global debt service.

** Merchandise exports are used for comparing Western and Communist ratios because export earnings data are not readily available for the latter nations.

***Includes only the LDCs that were in debt to the US and USSR in 1971.

in developed country markets. Communist willingness to accept cheap consumer goods from Egypt and India, foods from African nations, and crude products and raw materials not salable on world markets allows LDCs to pay their debt without creating pressures on limited foreign exchange reserves and hard currency earnings. It enables them to exchange otherwise surplus goods for development capital. Meanwhile, the demand for these goods generates domestic employment. Of particular advantage to the LDCs is the willingness of Communist nations to accept as repayment the output of plants built with Soviet aid, for which at least initially there may be no ready market. The weight of this repayment consideration differs among recipients, but it may be critical to the decision to accept Communist aid on what appears to be more burdensome terms than for Western aid: Iran's natural gas, previously flared as a waste product, is now paying for most of the annual flow of Soviet capital to Iran. Other Soviet-aided projects -- natural gas from Afghanistan, bauxite from Guinea, and alumina from Turkey -- will pay for Soviet aid. Steel rails from India and Soviet use of port facilities in Berbera, Somalia, also fall into this category.

Debt Relief

20. Debtor nations rarely have defaulted by outright refusal to honor their debts, and they have sought relief only as a last resort. Western and Communist creditors, although they both have been willing to renegotiate LDC repayment schedules where a real need has existed, have refused to provide automatic relief. In a *Pravda* article of 29 March 1973, Skachkov, Chairman of the State Committee of the USSR Council of Ministers for Foreign Economic Relations, stated: "Soviet economic assistance is not charity. It is given on a mutually advantageous basis and rests on the principles of equality and respect for mutual interest."

21. Both Western and Communist countries have given relief where there have been acute debt servicing problems.

22. Debt relief may take any of the following forms: (1) cancellation of the debt, (2) rescheduling of payments, or (3) refinancing the debt. Western nations are not known to have canceled principal payments although occasionally they have forgiven interest payments due. On a very few occasions, Communist countries have converted loans to grants.* Occasionally they have canceled interest payments. Debt rescheduling -- a rearrangement of maturities to eliminate a bulge in debt servicing -- is the most widely used form of relief provided by both Western and Communist creditors. The third form of relief -- refinancing (most commonly used by Western nations) -- implies a debt rollover in which new credits are extended to equal principal payments due on the outstanding debt. This relief implies that financed investments yield enough to pay the interest due. Sometimes debt rollover is combined with a rescheduling of maturities. Refinancing is not known to have been used directly as a relief device by Communist nations, although in some cases the resulting flow pattern after a rescheduling may effect a rollover.

23. Most major debt renegotiations with the West are conducted through multilateral channels, which create a procedural framework within which individual creditor nations effect bilateral settlements. These multilateral arrangements started in 1955 and 1956 to deal with large commercial arrearages accumulated by Brazil and Argentina with their West European trading partners. Broad rescheduling negotiations currently are under way among Western consortia with Chile, Ghana, India, and Pakistan. Communist countries usually have provided debt relief bilaterally, but often the East European nations follow Moscow's format. The renegotiation of Indonesia's debt to Communist nations was significant because most of the Communist creditors followed the Western accord.

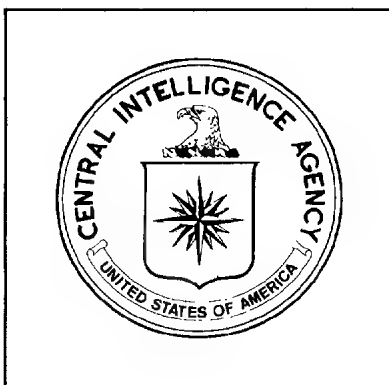
* China's conversion to grants of \$100 million of credits extended in 1964 and 1968 to Pakistan-Bangladesh is the most recent example.

Outlook

24. The pressure of debt servicing on LDC resources will become more burdensome in the latter half of the 1970s. Long grace periods, which have begun to expire, on loans granted earlier; the decline in the amount of grant aid sometimes offset by a higher volume of lending; and less concessional terms by some major lenders all will contribute to a continuing rapid rise in debt service. Even if debt service were to grow only as fast in the next five years as it did in the last five, by 1977 LDCs would have to make approximately \$6 billion in interest and principal payments. To sustain the amount of net aid transferred in 1972, and assuming the same concessional terms, the gross capital flow would have to be increased by about 30%. Nevertheless, as LDC import requirements grow and debt service rises, more of the LDCs will be forced to seek relief, and further accommodation to their hard currency shortages may have to be made. Western nations have recognized the relationship between debt relief and the conditions of aid. Communist nations have not, although they are more circumspect in their aid undertakings than before. Communist nations will continue to stress the "mutuality of interest," and so long as local goods are in surplus but acceptable as repayment for Communist aid, the burden on LDCs of making these repayments will be less than for Western aid. Thus the "means of repayment" probably will continue to condition the acceptability of further Communist aid in spite of the heavier debt service responsibilities and a probable negative flow of aid. Western nations will have to continue to accommodate to the problems related to limited LDC foreign exchange availabilities and the erosion of aid availabilities for development. But if Communist nations are unable to absorb LDC export surpluses (or if LDC goods can be disposed of for hard currency), Moscow and Eastern Europe may be forced to conform more closely to optimum aid criteria being pressed on the developed nations in international councils.

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*LDC Debt Service Burden: A Comparison
of Western and Communist Programs*

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LDC DEBT SERVICE BURDEN:
A COMPARISON OF WESTERN AND COMMUNIST PROGRAMS

Summary

1. The dilemma of increasing amounts of development assistance to the less developed countries (LDCs) in the face of rapidly expanding debt service is forcing a re-examination of the financial criteria for aid giving. Western nations, responsible for almost 95% of the gross bilateral flow of official capital to LDCs during 1954-72, are responding to international pressures to obtain uniform aid procedures. Communist countries are not. This situation exists in spite of the less favorable terms for Communist aid:

Communist aid has a smaller grant element than Western aid; it is paid off faster and absorbs a larger share of the annual gross capital flow; the cost per dollar of Communist aid delivered is higher than for Western aid; and Communist deliveries, net of payments for principal and interest, are declining while net Western aid transfers still are rising. The significant financial advantage of Communist aid is that it can be repaid in commodities (often not salable elsewhere) instead of hard currency. For some LDCs, this may mean the disposal of surplus goods for capital that will enhance development and generate employment.

2. Creditor nations expect the LDCs to meet repayment obligations and have provided debt relief only as a last resort. At the end of 1972 the LDCs had made principal and interest payments totaling about US \$21 billion for the almost \$115 billion of official bilateral capital provided them since the beginning of 1954. Still outstanding was some \$50

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billion in debts. If repayment of the LDC debt were to increase as rapidly over the next five years as during the past five, annual debt service would rise to about \$6 billion in 1977, or twice the 1972 level. To sustain current net aid transfers in 1977, official bilateral capital flows would have to increase by about 30% to more than \$13 billion.

Discussion

Introduction

3. The nations of the Third World are trying to acquire increasing external capital assistance at a time when their rising foreign debt service is burdensome. Both Western and Communist donors are pressed to expand their aid undertakings on more concessionary terms, sometimes to countries that are not able to discharge current obligations or whose debt service is absorbing an inordinate amount of the capital inflow. Anxious to strengthen their political and economic relationships with the LDCs, both are seeking solutions to the debt service problem that will allow debtors to sustain development efforts without severely impairing their import capability.

4. A continuing increase in the net capital flow to LDCs implies a major expansion of gross disbursements, additional softening of repayment terms, or relief from current debt obligations. Each expedient has been employed, often in combination, but consistent long-term approaches to the problem have only recently begun to emerge. In spite of these problems, both Eastern and Western creditors expect LDCs to pay for assistance provided under credits. Aid recipients, on the other hand, are eager to meet their obligations so as not to impair their credit-worthiness in international markets. This publication compares the debt management and financial benefits to the LDCs of the economic aid provided by Western and Communist nations. It also compares Western and Communist efforts to cope with a dwindling margin between new economic aid and debt service on old programs.

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Gross Capital Flows to the LDCs

5. During 1954-72 the LDCs received about \$113 billion in economic assistance from bilateral official sources in the developed world.* An estimated \$107 billion came from the West** and only slightly more than \$6 billion from Communist nations (see Table A-1 in the Appendix). Aid disbursements rose rapidly in the early years, climbing from an annual average of less than \$3 billion during 1954-59 to almost \$6 billion during the next five years. During 1965-69, aid outlays rose less rapidly because of relatively stable US disbursements. But, in 1970-71, deliveries rose by about 25% and approached a record \$10 billion annually.*** Although complete data for Western expenditures are not yet available for 1972, it is certain that they surpassed 1971 levels.

6. The recently expanded flow of capital reflects the rapid growth of disbursements by Western Europe and Japan. Increases in US aid have been small. US participation in the global flow totaled \$4 billion in 1971, 40% of the total. This was a drop from an average annual contribution of about 55% prior to 1970. The Communist countries' annual contribution to the global flow has been relatively constant since 1965 -- ranging between 6% and 7%. Their \$6 billion in aid deliveries during 1954-71 was only about 10% as large as US aid deliveries of \$55 billion and 40% as large as the \$15 billion provided by France, the second largest Western donor. Combined disbursements of the eight Communist nations were less than those of either the United Kingdom, Japan, or West Germany.

* Excluding private flows and multilateral assistance, which have totaled about \$80 billion.

** Throughout this publication, the term *West* refers to members of the Development Assistance Committee (DAC) -- Australia, Austria, Belgium, Canada, Denmark, France, Italy, Japan, the Netherlands, Norway, Portugal, Sweden, Switzerland, the United Kingdom, the United States, and West Germany.

***In addition, private gross flows, which have accounted for the greater part of the capital expansion flowing to LDCs in recent years, increased to \$12 billion in 1971, up from \$5 billion in 1965.

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The Cost of Capital

7. Payments of principal and interest on aid from all bilateral official sources have absorbed about 20% of the total assistance provided since the beginning of 1954. By 1970-71 these payments were about 30% of the annual total. For some recipients, the ratio was even higher, and for a few a reverse flow of resources was being generated, sometimes on both Communist and Western aid accounts. In the aggregate, LDC debt service has consumed a larger share of Communist than of Western aid. During 1954-72, principal and interest payments for Communist aid were some 30% of the total value of Communist aid deliveries. The ratio for Western aid was less than 20%. By 1971 the equivalent of about 45% of Communist aid deliveries went for debt service; in 1972 it was 55%. In contrast, repayments of LDC principal debt and interest to Western nations was absorbing only about 25% of the aid flow in 1971.

8. At the end of 1972, Third World nations had paid an estimated \$21 billion (\$14 billion for principal and \$7 billion for interest) on their bilateral official debt. About \$19 billion of the total went to Western nations and the remainder to the Communist countries (see Table 1). While both principal and interest payments moved consistently upward, especially since the mid-1960s, principal payments had grown faster (see Table A-2). These accounted for 70% of total debt service in 1971, compared with about 60% in 1965. Increases in recent years reflect the onset of payments following the expiration of grace periods and the somewhat shorter repayment periods allowed on many new undertakings.

9. Service of the LDC debt for official bilateral economic assistance more than doubled between 1965 and 1972. Repayments of principal and interest in 1972 approached \$3 billion,* compared with about \$1.2 billion seven years earlier (see Table 2). This means that debt servicing has grown as fast as the debt itself but much faster than aid receipts, which rose less than 50% between 1965 and 1971.

* Additional estimated payments due for private capital debt and dividend payments were roughly \$3.5 billion in 1971.

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Table 1

**Estimated LDC Debt Payments¹
for Official Bilateral Economic Aid, by Donor
1957-72²**

	Million Current US \$		
	Total	Principal	Interest
Total	21,370	14,310	7,060
Western countries	19,355	12,815 ³	6,535 ⁴
United States	10,500	6,750	3,750
Other	8,850	6,065	2,785
Communist countries	2,015	1,490	525
USSR	1,430	1,055	375
Eastern Europe	570	420	150
China	15	15

1. Data have been rounded to the nearest \$5 million. Because of rounding, components may not add to the totals shown.

2. Data for 1972 are preliminary.

3. Excluding possibly as much as \$1 billion of principal payments to governments that are not DAC members.

4. Including estimates of interest paid to DAC countries for 1957-67.

Table 2

**Estimated LDC Debt Payments¹
for Official Bilateral Economic Aid**

	Million Current US \$		
	Total	Western Countries	Communist Countries
Total	21,370	19,355	2,015
1957-63	4,275	4,105	170
1964	1,020	925	95
1965	1,240	1,135	110
1966	1,380	1,245	135
1967	1,470	1,315	155
1968	1,680	1,480	200
1969	2,020	1,795	225
1970	2,460	2,175	285
1971	2,850	2,540	305
1972 ²	2,970	2,630	340

1. Including principal and interest. Data have been rounded to the nearest \$5 million. Because of rounding, components may not add to the totals shown.

2. Preliminary.

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10. On the average, LDC repayments to Communist creditors have grown somewhat faster than to Western creditors, but the relative share of Communist creditors in the total repaid has not changed significantly over the past decade. Between 1965 and 1972, LDC debt service on Communist aid tripled; it more than doubled for Western aid. Nevertheless, at the end of 1972 the LDCs still owed Communist nations about \$4 billion, representing about two-thirds of total Communist aid delivered since the beginning of 1954. Their debt to the West was approximately \$46 billion, or less than 45% of total Western aid deliveries. Because of a much higher grant element in Western aid, the debt service per dollar of Communist aid delivered has been more than one and one-half times as high as for Western aid. The debt service/delivery ratio for Communist aid is about 30%, compared with about 20% for Western aid. Although Communist countries have provided only about 5% of the official bilateral capital that has flowed to LDCs, they have claimed almost twice that share of the total repaid on aid accounts.

11. Amortization of the LDC debt to Communist countries also has proceeded at a higher rate than on LDC debt to the West, while interest as a share of the total repaid dropped somewhat on both Eastern and Western accounts in recent years. Interest has constituted a larger share of LDC repayments for Western aid (about one-third) because of higher average charges and longer grace and amortization periods for Western official loan capital. Interest payments for Communist aid have accounted for about one-fourth of the total repaid (see Table A-2). Nevertheless, the cost per dollar of aid provided was less for Western than for Communist aid. This was mostly because of the more favorable Western terms. More than one-half of aid committed by Western nations and 45% of their deliveries have been grant aid.* Communist nations provided less than 5% of their total aid as outright grants, although, as a share of deliveries, grant aid was about 10%. In 1971, Western aid

* The United States, France, and the United Kingdom together provided more than 80% of the total grants (see Table A-3). All Australian aid is grant aid.

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commitments allowed amortization over an average of 28.7 years, after an average grace period of 6.5 years. Communist commitments carried an average of 11.5 years for amortization.* Average interest rates for Communist aid have been lower than for Western aid. Communist aid extended in 1971 carried interest charges averaging less than 2%, compared with 2.8% for Western commitments. Nevertheless, during 1965-72, interest payments to Western nations equaled 8% of the total value of their aid deliveries; it was 10% of Communist deliveries.

The Size of LDC Debt

12. At the end of 1972, the LDCs still owed an estimated \$50 billion to other governments for bilateral economic aid deliveries,** more than three times principal payments. LDC outstanding debt had reached more than \$20 billion at the end of 1964, and then during 1965-68 it nearly doubled. Debt rose somewhat more slowly over the next four years (1969-72), but at the end of 1972 it was two and one-half times the level at the end of 1964 (see Table 3 and Figure 1).

13. LDC debt to the West grew at a somewhat higher rate than debt to Communist nations, but the relationship between deliveries and outstanding debt has been more favorable for Western than Communist aid. Thus, in spite of the failure of Communist aid deliveries to grow as part of the total and in spite of the faster pay-off on LDC aid debt to Communist nations, the LDCs still owed Communist countries an estimated \$4.4 billion at the end of 1972.

* Grace periods for Communist aid cannot be compared with those for Western assistance because of definitional problems, except for the PRC which usually allows a 5-20 year lag between commitments and the onset of payments. Moscow normally requires initial principal payments one year after project completion, which may mean a delay in principal payments by 2-15 or more years after actual commitments are made.

** Private and privately guaranteed debt would probably add as much as \$40 billion to \$50 billion to this total. An additional \$10 billion to \$15 billion also may be outstanding for military aid deliveries.

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Table 3

**Estimated Outstanding External Bilateral
Official Debt of the Less Developed Countries
(End of Year)¹**

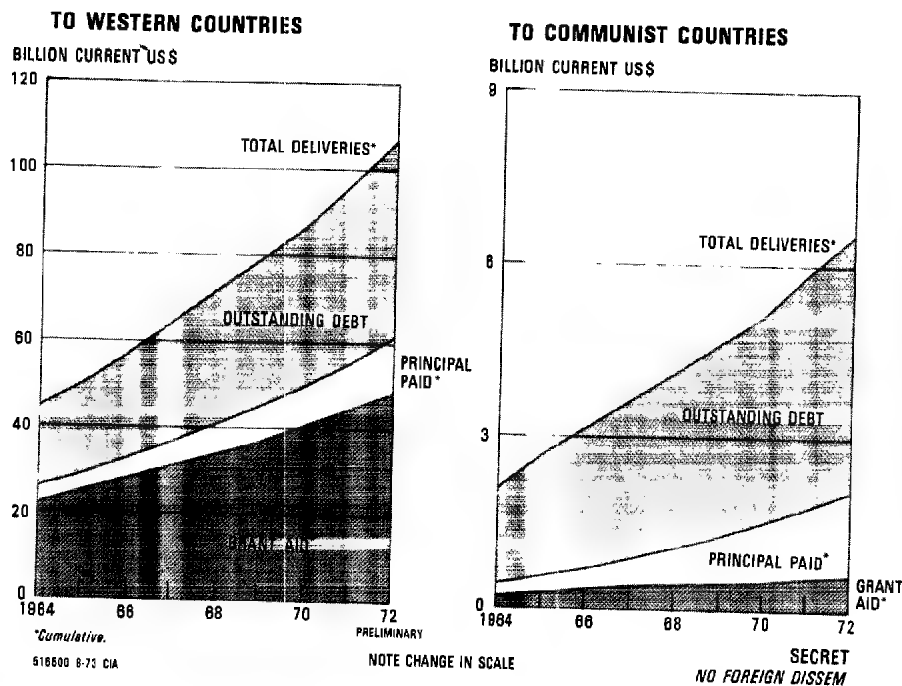
	Million Current US \$			
	1964	1968	1971	1972
Total²	20,124	34,434	45,500	50,021
Western countries	18,441	31,373	41,425	45,625
Communist countries	1,683	3,061	4,075	4,396

1. Including only disbursed debt. These are computed from estimated deliveries and repayments data. They are consistent with 1973 revisions of global outstanding debt estimated by DAC at \$80 billion for the end of 1971.

2. In 1971 and 1972 an estimated \$1 billion should be added for the account of other Western non-DAC countries.

FIGURE 1

**ESTIMATED OUTSTANDING OFFICIAL BILATERAL DEBT
OF LESS DEVELOPED COUNTRIES**



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Net Aid Transfer: The Critical Factor

14. The size of a nation's debt is not necessarily a measure of strains on its economy, nor is the size of its debt service ratio.* Problems usually occur when the debtor cannot settle trade and aid accounts because debt servicing is encroaching on its import capacity. Thus, because of variations in domestic economic conditions, LDCs have sought debt relief at very different stages of indebtedness and at different debt service ratios. Generally, their problems reflect a combination of external and domestic factors that surface when debtors' foreign exchange availabilities are not adequate to honor external obligations or if, by honoring them, domestic development objectives are jeopardized.

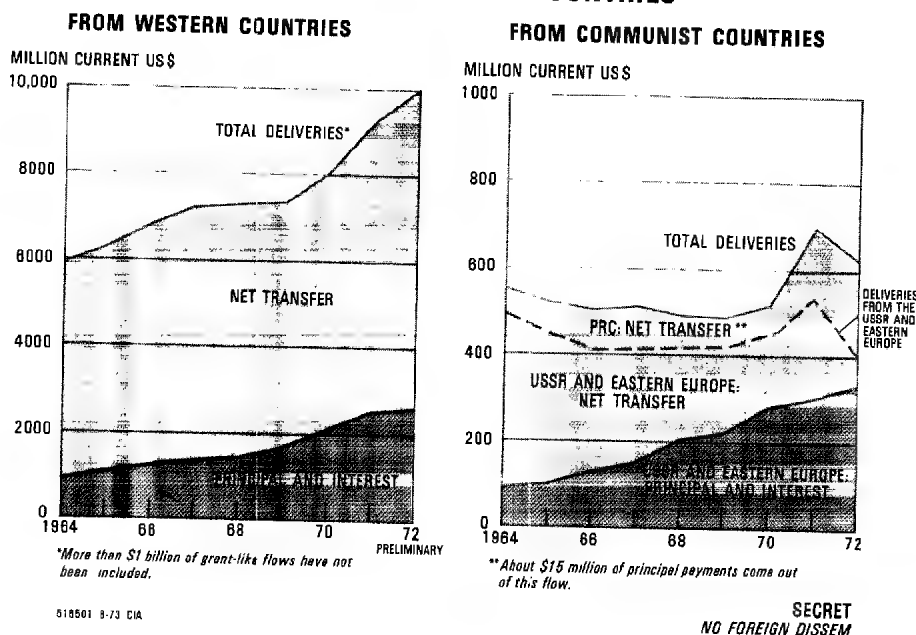
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16. The failure of capital flows to expand sufficiently to compensate for the more rapidly growing debt service has led to an overall deterioration in the expansion of net aid transferred over time. Even though gross capital flows to the Third World from official bilateral sources have been increasing in the past few years, the rate of increase, net of debt service, has decelerated, and net availabilities from some donors have dropped. Even the 15% increase in net official bilateral capital transfers during 1971 was considerably less than an effective addition to LDC capital availability because of inflation. Nevertheless, net aid transfers from the West have continued to grow. Since the beginning of 1965, those from Communist nations have fallen (see Figure 2). The divergence in the net transfer

* The ratio between total debt service and total export earnings.

NET TRANSFER OF OFFICIAL BILATERAL CAPITAL TO LESS DEVELOPED COUNTRIES

FIGURE 2



patterns between Communist and Western aid programs probably is the most important difference to have emerged between the two programs. It is the result of the much larger growth in gross flows from Western nations as well as qualitative differences in Western and Eastern programs. One of the most important factors responsible for the difference is the high grant element of Western aid (82% for commitments made in 1971).* Under the most liberal interpretation of current Communist aid terms, the grant element would be no more than 35%-40%.

17. Net aid receipts from the West have grown in almost every year since 1954. They rose rapidly during the first decade of the aid program (1954-63) because of sharply expanding aid deliveries and large amounts of grant aid. Then, between 1964 and 1969 deliveries leveled off. More concessionary terms of aid and debt relief continued to provide some

* The grant element measures the concessionary element of aid terms. It is derived by relating the present value of interest, principal payments, and the length of the grace period.

growth in receipts. Larger gross flows in 1970-72 again contributed to a continuing increase in Western net aid transfers. Meanwhile, the net flow of Communist aid had fallen, from a record \$465 million in 1964 to \$280 million in 1972. The decline was noted in every year until 1971, when unusually large Chinese aid deliveries, made before large repayments on Chinese aid fell due, drove the net up somewhat. If Chinese aid deliveries are excluded from the Communist total, the narrowing gap between deliveries and repayments is even more pronounced: a net of only \$60 million moved under these accounts in 1972, down from \$395 million in 1964. Unless there is a marked change in Communist aid policy, the net flow will fall to zero and then become negative in the next several years.

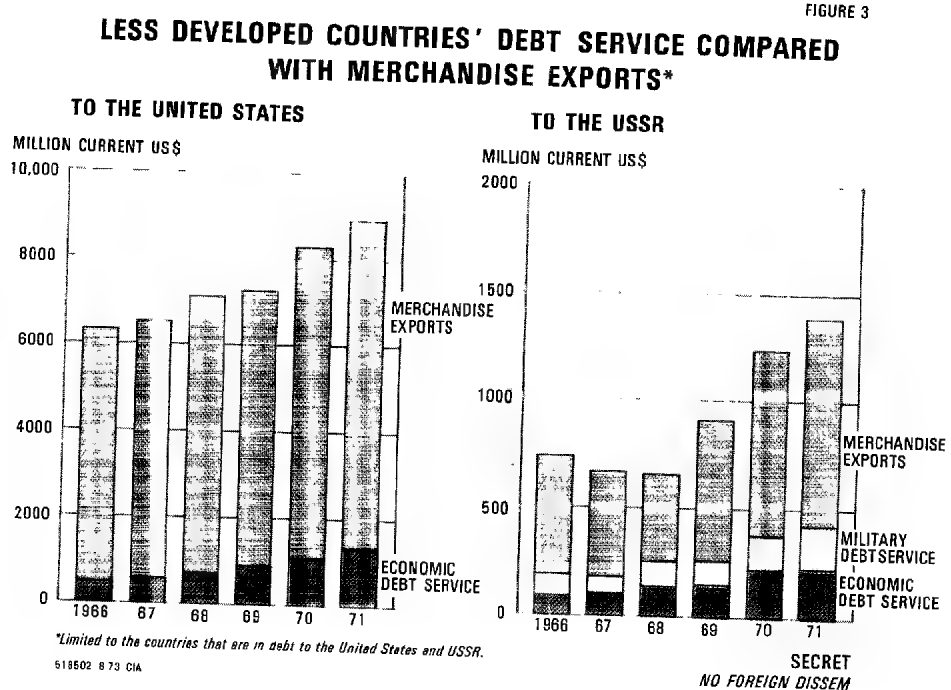
Impact of Debt Service on the LDCs

18. Debt service on all LDC accounts* was equivalent to about 15% of total merchandise exports from these nations in 1971, slightly higher than in 1966. The ratio is higher for some countries and groups of countries. For example, it was 25% for South Asia because debt payments more than doubled while merchandise exports increased by only 20% between 1965 and 1971. In the aggregate, the ratio of debt service to total merchandise exports** for Communist and Western official bilateral aid was roughly the same, but the ratio was far higher for the USSR than for the United States. Soviet debt service as a percent of LDC merchandise exports has run about twice as large as for the United States. During 1969-71, about 30% of total merchandise exports from Soviet aid clients was devoted to repayment of their aid debt to the USSR. During the same period, LDC repayments to the United States ranged between 10% and 15% of the total exports of LDCs that had received credits from the United States. In 1966 the ratio for the United States was 10%, compared with 25% for the USSR (see Figure 3).

* Based on data for 80 LDCs and including private and privately guaranteed debt servicing as well as multilateral global debt service.

** Merchandise exports are used for comparing Western and Communist ratios because export earnings data are not readily available for the latter nations.

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19. These ratios for Communist and Western countries may not be exactly comparable for measuring LDC ability to repay debts. Communist aid may be easier to repay than Western aid because of the "means of repayment." Most Western aid is tied to purchases in the donor country, but repayment of principal and interest is in free foreign exchange. Communist aid also is "tied," but repayment is in local goods. Commodities used as repayment for LDC debts to Communist creditors would be equivalent to hard currency payments if they could be sold for hard currency, but frequently these goods cannot be disposed of, because of their inferior quality, a lack of demand, or other barriers in developed country markets. Communist willingness to accept cheap consumer goods from Egypt and India, foods from African nations, and crude products and raw materials not salable on world markets allows LDCs to pay their debt without creating pressures on limited foreign exchange reserves and hard currency earnings. It enables them

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to exchange otherwise surplus goods for development capital. Meanwhile, the demand for these goods generates domestic employment. Of particular advantage to the LDCs is the willingness of Communist nations to accept as repayment the output of plants built with Soviet aid, for which at least initially there may be no ready market. The weight of this repayment consideration differs among recipients, but it may be critical to the decision to accept Communist aid on what appears to be more burdensome terms than for Western aid: Iran's natural gas, previously flared as a waste product, is now paying for a \$100 million annual flow of Soviet capital to Iran. Other Soviet-aided projects -- natural gas from Afghanistan, bauxite from Guinea, and alumina from Turkey -- will pay for Soviet aid. Steel rails from India and Soviet use of port facilities in Berbera, Somalia, also fall into this category.

Debt Relief

20. Debtor nations rarely have defaulted by outright refusal to honor their debts, and they have sought relief only as a last resort. Western and Communist creditors, although they both have been willing to renegotiate LDC repayment schedules where a real need has existed, have refused to provide automatic relief. In a *Pravda* article of 29 March 1973, Skachkov, Chairman of the State Committee of the USSR Council of Ministers for Foreign Economic Relations, stated: "Soviet economic assistance is not charity. It is given on a mutually advantageous basis and rests on the principles of equality and respect for mutual interest."

21. Debts totaling about \$3 billion (including private commercial debt) have been renegotiated between more than a dozen LDCs and their Western creditors. Communist countries have given relief to as many countries, with deferred payments of about \$200 million. Although many LDCs bear heavy debt service burdens, most of them have been able to maintain a reasonable balance between debt servicing liabilities and exports. Acute debt servicing problems have affected only a few LDCs, although some countries have had temporary problems

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because of the bunching of payments or severe fluctuations in export earnings. The latter countries have sought temporary relief; others, with sustained shortages of foreign exchange and severe imbalances in their debt structure, have sought broader corrective measures. Seven countries* were responsible for more than 80% of the LDC total outstanding debt to the USSR at the end of 1972. Except for Afghanistan, Indonesia, and Syria, these countries have met their obligations. India, Iran, and Indonesia also account for a large portion of LDC debt to the West. With Pakistan, Brazil, Mexico, South Korea, and Turkey added to the list, these nations account for one-half of the LDC total debt to the West.

22. Debt relief may take any of the following forms: (1) cancellation of the debt, (2) rescheduling of payments, or (3) refinancing the debt. Western nations are not known to have canceled principal payments although occasionally they have forgiven interest payments due. On a very few occasions, Communist countries have converted loans to grants.** Occasionally they have canceled interest payments. Debt rescheduling -- a rearrangement of maturities to eliminate a bulge in debt servicing -- is the most widely used form of relief provided by both Western and Communist creditors. The third form of relief -- refinancing (most commonly used by Western nations) -- implies a debt rollover in which new credits are extended to equal principal payments due on the outstanding debt. This relief implies that financed investments yield enough to pay the interest due. Sometimes debt rollover is combined with a rescheduling of maturities. Refinancing is not known to have been used directly as a relief device by Communist nations, although in some cases the resulting flow pattern after a rescheduling may effect a rollover.

23. Most major debt renegotiations with the West are conducted through multilateral channels,

* Afghanistan, Algeria, India, Iran, Indonesia, Iraq, and Syria.

** China's conversion to grants of \$100 million of credits extended in 1964 and 1968 to Pakistan-Bangladesh is the most recent example.

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which create a procedural framework within which individual creditor nations effect bilateral settlements. These multilateral arrangements started in 1955 and 1956 to deal with large commercial arrearages accumulated by Brazil and Argentina with their West European trading partners. Broad rescheduling negotiations currently are under way among Western consortia with Chile, Ghana, India, and Pakistan. Communist countries usually have provided debt relief bilaterally, but often the East European nations follow Moscow's format. The renegotiation of Indonesia's debt to Communist nations was significant because most of the Communist creditors followed the Western accord.

Outlook

24. The pressure of debt servicing on LDC resources will become more burdensome in the latter half of the 1970s. Long grace periods, which have begun to expire, on loans granted earlier; the decline in the amount of grant aid sometimes offset by a higher volume of lending; and less concessional terms by some major lenders all will contribute to a continuing rapid rise in debt service. Even if debt service were to grow only as fast in the next five years as it did in the last five, by 1977 LDCs would have to make approximately \$6 billion in interest and principal payments. To sustain the amount of net aid transferred in 1972, and assuming the same concessional terms, the gross capital flow would have to be increased by about 30%. Nevertheless, as LDC import requirements grow and debt service rises, more of the LDCs will be forced to seek relief, and further accommodation to their hard currency shortages may have to be made. Western nations have recognized the relationship between debt relief and the conditions of aid. Communist nations have not, although they are more circumspect in their aid undertakings than before. Communist nations will continue to stress the "mutuality of interest," and so long as local goods are in surplus but acceptable as repayment for Communist aid, the burden on LDCs of making these repayments will be less than for Western aid. Thus the "means of repayment" probably will continue to condition the acceptability of further Communist aid in spite of the heavier debt service responsibilities and a probable negative flow of aid. Western

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nations will have to continue to accommodate to the problems related to limited LDC foreign exchange availabilities and the erosion of aid availabilities for development. But if Communist nations are unable to absorb LDC export surpluses (or if LDC goods can be disposed of for hard currency), Moscow and Eastern Europe may be forced to conform more closely to optimum aid criteria being pressed on the developed nations in international councils.

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APPENDIX

Table A-1

Gross Official Bilateral Capital Flows from Developed
to Less Developed Countries¹

	Million Current US \$											
	Total 1954-71	1954-59	1960-64	1965	1966	1967	1968	1969	1970	1971	1972	Total 1954-72
Total	102,872	17,255	29,376	6,896	7,327	7,724	7,834	7,862	8,607	9,991	10,620²	113,492
Western ³	97,048	16,878	27,665	6,373	6,821	7,211	7,345	7,374	8,088	9,293	10,000 ²	107,048
United States	54,174	10,452	17,670	3,664	3,803	3,802	3,775	3,498	3,510	4,000	N.A.	N.A.
France	14,624	4,260	3,900	793	791	847	913	963	1,039	1,118	N.A.	N.A.
West Germany	6,640	408	1,610	522	556	611	643	675	718	897	N.A.	N.A.
United Kingdom	6,585	1,038	2,040	491	530	509	458	427	487	605	N.A.	N.A.
Japan ⁴	6,366	180	790	299	478	580	687	892	1,177	1,283	N.A.	N.A.
Other ⁵	8,659	540	1,655	604	663	862	869	919	1,157	1,390	N.A.	N.A.
Communist	5,824	377	1,711	523	506	513	489	488	519	698	620	6,444
USSR	3,847	255	1,270	354	335	297	297	321	335	383	308	4,155
Eastern Europe	1,161	63	322	91	80	115	122	99	120	149	91	1,252
China	816	59	119	78	91	101	70	68	64	166	221	1,037

1. Total gross official capital flows include grants (less reparation and indemnification payments); gross loans with maturities of five years or more; for 1965-71, gross loans with maturities of one to five years (these, however, amount to less than 4% of the total for that period); and net grant-like flows from Western nations (loans repayable in recipients' currencies and transfers of resources through sales for recipients' currencies). These capital inflows include what has been recently defined as Official Development Assistance (ODA) and other official aid, exclusive of private export credits that are publicly or officially guaranteed.

2. Preliminary.

3. Including only members of the Development Assistance Committee of the Organization for Economic Cooperation and Development (OECD). Capital from other sources probably would not add more than 5% to the total.

4. For 1960-65, net export credits are included. For other years, gross credits are used.

5. Including Australia, Austria, Belgium, Canada, Denmark, Italy, Norway, the Netherlands, Portugal, Sweden, and Switzerland. Australia became a member of the DAC in 1966, and its bilateral flows are counted only since 1965. Disbursements by all donors to Yugoslavia are excluded.

Table A-2

Debt Service for Official Bilateral Capital Flows
from Developed to Less Developed Countries

	Million Current US \$											
	Total 1957-72	1957-59	1960-64	1965	1966	1967	1968	1969	1970	1971	1972 ¹	
Total	21,369	1,549	3,747	1,241	1,380	1,470	1,683	2,020	2,461	2,849	2,969	
Principal	14,308	1,348	2,277	766	860	921	1,043	1,330	1,707	1,998	2,058	
Interest	7,061	201	1,470	475	520	549	640	690	754	851	911	
Western	19,353	1,525	3,506	1,133	1,245	1,316	1,482	1,797	2,177	2,542	2,630	
Principal	12,817	1,330	2,112	691	763	809	896	1,167	1,487	1,762	1,800	
Interest	6,536	195	1,394	442	482	507	586	630	690	780	830	
Communist	2,016	24	241	108	135	154	201	223	284	307	339	
Principal	1,491	18	165	75	97	112	147	163	220	236	258	
Interest	525	6	76	33	38	42	54	60	64	71	81	

1. Preliminary.

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Table A-3

Official Bilateral Grant Aid Deliveries
to Less Developed Countries

	Million Current US \$			
	1954-71	1954-59	1960-68	1969-71
Total	45,121.5	10,705.9	24,056.7	10,358.9
Western	44,605.6	10,666.7	23,651.9	10,287.0
Australia	1,568.0	185.0	853.7	529.3
Austria	24.9	15.8	9.1
Belgium	970.8	10.0	696.8	264.0
Canada	1,329.8	206.4	694.2	429.2
Denmark	79.1	28.7	50.4
France	9,702.3	1,610.9	5,794.3	2,297.1
Italy	355.6	38.6	184.0	133.0
Japan	825.6	178.5	277.4	369.7
Netherlands	741.1	116.8	255.0	369.3
Norway	103.6	28.9	32.6	42.1
Portugal	96.4	1.6	57.6	37.2
Sweden	273.3	52.8	95.4	125.1
Switzerland	82.9	0.3	33.4	49.2
United Kingdom	3,267.9	600.1	2,002.6	665.2
United States	23,704.4	7,625.0	11,901.4	4,178.0
West Germany	1,479.9	11.8	729.0	739.1
Communist	515.9	39.2	404.8	71.9
USSR	248.5	12.5	211.9	5.6
Eastern Europe	10.1	0.6	8.4	1.1
China	298.7	26.1	184.5	65.2

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